

Conference on

“Developing a Tax Environment for Growth and Competitiveness”

Main Issues and questions for discussion

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An overview issue paper

Session 1: The Changing International Environment for Tax Policies

(See Background Notes 1 and 8)

The current financial and economic crisis is having a profound impact on economies around the world. Governments are simultaneously facing the challenge of managing fiscal austerity and promoting structural reforms to encourage growth and to improve competitiveness. All this is taking place against the background of persistent high unemployment. At the same time policy makers are facing fundamental longer term issues such as energy transition and climate change. They also have to deal with the growing inequality of distribution of income and wealth within their societies as well as at a global level.

The traditional patterns of global economic governance rules are also being put in question. New groupings, such as the G20, have emerged; existing multilateral institutions such as OECD and the IMF are reassessing their role. The EU is embarking on an ambitious policy of completing the single market and putting in place a framework for an EU wide banking regulatory and fiscal union. This process of change is politically challenging and socially difficult, especially as there is a shift of influence to emerging economies. New types of multinationals (MNEs) based outside of the OECD area and a more active and engaged civil society are emerging.

This is the background against which governments are re-examining their tax systems.

Over the last two decades, almost all of the OECD countries and emerging economies have undertaken major structural reforms to their tax systems:

1. Top personal and income tax rates have been significantly cut, the number of brackets reduced and the base broadened
2. Corporate income taxes have also been reduced, in some cases more than halved, with exception of areas like research and development and energy conservation, tax reliefs have been scaled back
3. VAT/GST have become the dominant form of tax in consumption, with over 160 countries now applying these taxes.
4. Social security contributions have been restructured, removing caps on the contribution base, bringing in non-wage income, shifting the balance between employers and employees.
5. Many taxes on capital and wealth have been removed or lightened; net wealth taxes have all but disappeared in the OECD area; inheritance taxes have been eliminated or made significantly lighter; capital gains taxes either abolished or subject to special low tax regimes.
6. Taxes on land and buildings are being redesigned to take advantage of the new technologies available for maintaining the valuations of properties up to date

7. Environmental taxes are beginning to become more extensively used, although their contribution to the total tax revenues remain very small.
8. Governments are placing a new emphasis on tax compliance taking action individually and collectively against the abuse of off-shore transactions.
9. Developing countries are increasingly conscious of the need to mobilise domestic resources through taxation and are working on increasing the efficiency of their tax systems.

The overall impact of these changes is to make tax systems more responsive to growth and competitiveness, fairer, although not simpler. These changes also tend to shift the tax burden away from taxes on profit, dividends, royalties and interest to taxes on consumption and wages.

Questions for the panel

What impact is globalisation having on tax systems?

What are the implications for groupings such as the EU and the OECD?

Are there trade-offs between designing tax systems which are pro-growth and tax systems which are both fair and simple? And if so, how are politicians reconciling these trade-offs?

Is there a need to upgrade multilateral co-operation and rule setting on tax issues to formulate responses to global pressures?

Session 2: Tax policies: Meeting the Challenges

(See Background Note 2)

This panel will examine how countries are designing their tax systems to minimise any impact on sustainable growth. Few now contest the legitimacy of designing tax systems in the interest of promoting growth and investment but any competition that results has to follow rules of the game and should not unfairly erode the tax base of the countries concerned.

To improve the domestic competitiveness of an economy, taxes must influence what the world economic forum referred to as the 12 pillars of competitiveness. Tax can influence the institutional pillar by raising revenues in a broadly acceptable way and by means of a tax administration which is open, transparent and non-corrupt. Tax is also an important contributor to reaching a social macroeconomic environment and improving skill levels. Taxation can also contribute to enhancing market efficiency, particularly by moving to low rate, broad based, tax systems. As regards labour markets, tax policy can try to reduce the tax wage on labour and thereby have a positive impact on the functioning of labour markets. Many governments are convinced that tax incentives provided for innovation are good investment. Financial markets development, market size and business sophistication are also susceptible to being influenced by tax taxation.

At the international level, tax systems are increasingly being used to attract foreign direct investment, portfolio investment and highly skilled parts of the labour force. Countries are using a

variety of measures to achieve this: reducing tax rates; designing special tax regimes for mobile activities (e.g. IP boxes) or individuals (high net wealth individuals); governments are also using tax administrations to provide a more predictable and more business friendly tax environment.

Questions for the panel

How important is tax in location decisions for companies and individuals?

What taxes are particularly relevant?

What is the importance of an effective and fair tax administration?

How can we improve the transparency of tax incentives? Should there be a systematic assessment of cost/benefit of these schemes?

Do we need tougher rules on what is acceptable or unacceptable as regards to tax competition? And if so, what routes should the EU code of conduct and the OECD guidelines on harmful tax practices take?

Session 3: The role of taxation and good governance in reducing inequalities and improving fairness in developed and developing countries

(See Background Notes 3 and 6)

Over the last two decades, real disposable income increased by an average of 1.7% a year in OECD countries. In a large majority of them, household incomes of the richest 10% grew faster than those of the poorest 10%, so widening incomes in inequality. Differences in the pace of income growth across household groups were particularly pronounced in some of the English speaking countries and the Nordic Countries. In the OECD countries the average income of the richest 10% of the population is now about 9 times that of the poorest 10%; a ratio of 9 to 1. However, the ratio varies widely from one country to another. It is much lower than the OECD average in the Nordic and many continental European countries but reaches 10:1 in Italy, Japan, Korea and the United Kingdom; around 14:1 in Israel, Turkey and the United States; and 27:1 in Mexico and Chile.

The Gini coefficient, a standard measure of income inequality that ranges from 0 (when everyone has identical incomes) to 1 (where all income goes to only one person), stood at an average of 0.29 in OECD countries in the mid-1980s. By the late 2000s, however, it had increased by almost 10% to 0.316. Significantly it rose in 17 of the 22 OECD countries for which long term data is available, climbing by more than 4 percentage points in Finland, Germany, Israel, Luxembourg, New Zealand, Sweden and the United States.

Income inequality followed different patterns across the OECD. It first started to increase in the late 1970s and early 1980s in some English speaking countries, notably the United Kingdom and the United States. From the late 1980s, the increase in income inequality became more widespread. The

latest trends in the 2000s show a widening gap between rich and poor. Not only in some of the already high income inequality countries like Israel and the United States, but also, for the first time, in traditionally low income inequalities such as Germany, Denmark and Sweden, where inequality grew more than anywhere else. At the same time, Chile, Mexico, Greece, Turkey and Hungary reduced inequality considerably, often from high levels.

Increases in household income inequality have been largely driven by changes in the distribution of wages and salaries, which count for 75% of household income amongst working age adults. With very few exceptions, the wages of the 10% best paid workers has risen relative to those of the lowest 10% paid. This was due to both growing earnings share at the top and declining shares at the bottom, although top incomes saw their incomes rise particularly rapidly. Earners in the top 10% have been leaving the middle earners behind more rapidly than the lowest earners have been drifting away from the middle.

The 2008 OECD report (on growing inequality) highlighted that inequality in the distribution of market incomes (gross wages, income from self-employment, capital income and returns from savings taken together) increased in almost all OECD countries between the mid-1980s and mid-2000s. Changes in the structure of households due to factors such as population aging or the trend to a smaller household size played an important role in several countries. At the same time government actions, whether in the form of taxes or cash transfers became less effective in reducing high levels of market inequality, particularly during the late 1990s and early 2000s.

Questions for the Panel

What are the major underlying causes of change in equality?

Is globalisation the main culprit? Or is it technological change?

To what degree would changes in labour and product markets policies and regulations be responsible?

Do changes in household structure matter?

What can governments do to address rising inequality?

What role is there for taxation to reduce income inequalities, particularly at the higher end of the income scale?

How can tax systems contribute to reduce the inequality among countries? Which taxes are best to promote sustainable development?

Session 4: Tax transparency and harmful tax practices

(See Background Notes 7 and 9)

Cross border information exchange by tax authorities is nothing new, both the UN and OECD model convention have for many years contained an article 26 and most countries which have bilateral

treaties have this article in them. Nevertheless, what we have seen over the last 5 years is a seismic shift with more pressures on countries to remove their bank secrecy as a barrier which behind tax evaders can operate. Exchange of information on request is now an accepted international norm and since the London G20 summit in April 2009, we have seen an explosion in the exchange of information agreements linking different countries. Tax Authorities across borders are co-operating in an unprecedented fashion and significantly more data is moving from one tax authority to the other. The impetus for this change came following the G20 meeting in London, 2009, the heads of governments recognised the crisis had meant that they needed more revenues and also they needed to show their citizens that the tax burden was being fairly shared. The G20 initiative was able to build upon more than 20 years of technical work that the OECD's Committee of Fiscal Affairs had undertaken.

Today, the policy in the regular environment for information exchange on tax matters has changed substantially. The OECD's global forum on transparency and the exchange of information for tax purposes now extends well beyond core developed markets to include both economies in transition, developing countries and offshore financial centres. Also the international organisations are now playing an active role in the forum as are regional bodies such as the African Tax Administration Forum. Few now contest that effective exchange of information is an essential part of a well regulated and stable financial global system.

In April, 2009, the OECD issued its first list of jurisdictions which failed to implement effective exchange of information. Countries were scaled as being black, grey or white depending on the number of agreements that they had which met the new standard. Less than 12 agreements would put them in the grey or the black category. Today, what we see is that all of the jurisdictions that were in the original black or grey list have been moved into the white part of the list, except for two and that the global forum has in fact put in place a robust peer review mechanism to ensure that not only countries endorse the standards but that they implement them in practice. The rise of information exchange has significant implications not only for high net wealth individuals that use offshore financial institutions to evade taxes back home but also for corporations because today the tax authorities of one country can ask the tax authorities in offshore jurisdictions (sometimes referred to as tax havens) to provide information in a whole range of issues, including transfer pricing, aggressive tax planning, sophisticated financial structures. Since April 2009, the number of bilateral exchange agreements have increased from 40 to almost 800 and the number continues to grow.

At the EU level, there has also been a new emphasis on moving forward on the interest saving directive which requires EU member states to provide automatically other member states with certain information with respect to cross border interest flows. Ultimately the directive is intended to achieve full automatic exchange of information for all 27 member states (at the moment Austria and Luxembourg have chosen the withholding rather than the exchange option). Today though the EU is trying to extend this directive into new areas and to push forward on the automatic exchange of information on incomes such as employment income, director's fees, the insurance products not directly covered by the original saving directive.

Yet another information exchange initiative is the US foreign account tax compliance act (FATCA) which is aimed at preventing tax evasion by US citizens and residents through the use of offshore accounts. What we are seeing today with the development of inter government agreements in the

context of FATCA is the first steps towards a global reporting system backed up by automatic exchange.

Clearly we are at a watershed in the area of exchange of information. We are beginning to see a move towards multilateralisation of these agreements. On 1st June 2011 an amended Convention on Administrative Assistance in Tax Matters (multi-lateral OECD agreement) came into force and today there are 50 countries that have either signed the agreement or have stated the intention to do so, including all of the G20 countries. We are also seeing exchange of information requests being complimented by movement towards automatic exchange of information and governments being prepared to put more resources to ensure that in practice, both bi-lateral and multi-lateral agreements on exchange are effectively implemented.

In parallel with the increase in exchange of information we have seen governments put in a new emphasis on improving the transparency of the operation of multinational enterprises. We have the extractive industry initiative which is intended to encourage multinationals and governments in resource rich countries to publish the revenues paid and received from the extraction of natural resources and thereby to make governments more accountable for their citizens. We have also seen the Dodd-Frank Act in the United States which places a statutory obligation on all US quoted companies operating in the extractive industry to publish on a country by country basis and project by project basis the income received and taxes paid. It is also expected that shortly the EU will in fact propose a directive to apply the Dodd Frank approach to listed companies within the EU. More generally, NGOs are pushing to put in place a global scheme of country by country reporting of income and taxes paid in all sectors of the economy.

Questions for the Panel

What impact has the G20/OECD initiative had in practice? Has it changed the attitudes of high net wealth individuals and bankers to off shore non compliances? Will it change the attitudes of multinationals in determining their activities in offshore jurisdictions?

Are we now on the threshold of a move from exchange of information on request to automatic exchange? And will this now become the International standard? If so, what are the implications for the global forum standard?

As more countries sign the multilateral convention, how will this interact with bi-lateral agreements?

Will FATCA change the whole dynamics of dealing with offshore non-compliance? Will the intergovernmental agreements be the first step towards a global reporting standard on financial institutions backed up by automatic exchange of information?

What do governments need to do in this more transparent environment to protect the confidentiality of the information exchanged?

Should the EITI/Dodd Frank initiatives be extended to sectors beyond the extractive industry?

Is there a case for a global transparency standard in this area?

What are the risks and benefits of a move towards country by country reporting?

Session 5: Taxing Multinational Enterprises - Getting the right balance

(See Background Notes 4, 5 and 10)

Multinational enterprises are under unprecedented pressure because of the low effective tax rates that they pay in certain jurisdictions. The G20 have asked the OECD to initiate a project on base erosion and profit shifting. The OECD is shifting its focus on transfer pricing away from refining its 1995 guidelines to achieving a better implementation of them. It is also looking at how it can reduce the complexity of transfer pricing audits by trying to find simpler solutions to deal with routine transactions (e.g. safe harbours). It is also in fact working hard on a project looking at the taxation of intangibles and whether the existing rules are capable of dealing with these very complex transactions.

In December 2012, the EU issued a major communiqué on tax evasion and avoidance and that also puts much emphasis on encouraging multinationals to have a stronger compliance both with a spirit and the letter of the law. Finally, the United Nations recently issued a manual on the application of the arm's length principle which is intended to help developing countries achieve a consistent and fair application.

At the centre of the debate on taxation of MNEs is the issue of transfer pricing. Some are now questioning whether the arm's length principle/separate entity approach is "fit for purpose". The EU, with its consolidated corporate tax base is proposing that all EU countries would use this as the basis for corporate taxation. This would imply a move away from the arm's length approach. There are also some in the US congress who would like to see this move made at an international level.

Recently hearing in the US, France, UK and elsewhere have shown that today there is significant political pressure for change and the question that remains is whether this change will take the form of a continued adaptation of the arm's length principle, particularly in the area of intangibles or whether we will now actually see a move away from the traditional approaches that the OECD has put forward for many years.

Questions for the Panel

Since the existing rules enable multinationals to achieve very low effective tax rates, does this mean that there is now a need to revise these rules?

Alternatively, have we now reached the end of the road for the arm's length principle? Are there other systems (e.g Unitary Taxation) which are fairer and more effective while not creating the risk of double taxation? Are these realistic options and if so, how can we move from one system to the other system?

What is the appropriate treatment of intangibles, since if we can find a new international consensus on that, this would take off much of the current pressure that we see in the area of taxation for multinational enterprises?

What can be learnt from the views set out by Brazil, China, India and South Africa in Chapter 10 of the UN manual, especially use the issue of locational savings? Would these approaches lead to a fairer division of the tax base or would they increase the risk of double taxation or double non taxation?

Section Six: Providing a framework for policy makers

Policy makers in developed and developing countries have to make trade-offs between efficiency, fairness, environmental and simplicity objectives set for tax systems. Getting the right balance between these goals is the art of tax reforms. Today there is no shortage of proposals on how tax systems should be reformed, yet most reforms have tended to be incremental rather than major structure changes.

Questions for the Panel

What framework is available to enable national tax policy makers to have an informed debate on these trade-offs?

Do we need more independent Office of Budget Management, Fiscal Responsibility Offices etc.? Would having regular comprehensive tax expenditure budgets improve the debate?

Should governments be forced to do a scoring of who would benefit and who would lose from particular reforms and what would be the impact on long term revenues? Should they also insist on having a post reform evaluation of the changes that have been made?

Does it help to engage business and other parts of civil society in the policy formulation and implementation stage?

How do we reconcile the need for stability with the need to adapt the tax system to a rapidly changing political and economic environment?

What role is there for regional and international organisations both in the level of policy formulation (e.g. identifying best practices, setting guidelines and even having mandatory policy recommendations)? And what role do they have in providing the analytical framework and analysis to enable policy makers to evaluate any reform proposals?